

SECTION 242/241 APPLICATION POLICY GUIDANCE REGARDING OPINION LETTERS FOR STUDIES OF MARKET NEED AND FINANCIAL FEASIBILITY

JUNE 2005

INTRODUCTION

This policy is intended to provide guidance for the documentation of need in the opinion letter for a Study of Market Need and Financial Feasibility.

BACKGROUND

PL108-91 amended the section 242 of the National Housing Act with respect to need. The revised statute states that:

“The Secretary shall establish the means for determining need and feasibility for the hospital, if the State does not have an official procedure for determining need for hospitals. If the State has an official procedure for determining need for hospitals, the Secretary shall require that such procedure be followed before the application for insurance is submitted, and the application shall document that need has also been established under that procedure.”

Additional guidance was provided in Mortgagee Letter 04-08 issued in February of 2004. Mortgagee letter 04-08 provides guidance as to how a hospital can document need. The hospital documents need in its study of Market Need and Financial Feasibility. Mortgagee letter 04-08 identified several factors that are relevant in evaluating market need. These elements should be addressed in the body of the Study of Market Need and Financial Feasibility, as applicable. *“Because each hospital presents a unique situation, there is no formula or cutoff level that applies to all applications.”*

FACTORS TO BE CONSIDERED IN EVALUATING NEED

From Mortgagee Letter 04-08:

- a. *Service area definition*
- b. *Existing or proposed hospital*
- c. *Designation as sole community provider, critical access hospital, or rural referral center*
- d. *Community-wide use rates (discharges and days/1000)*
- e. *State-wide use rates (for benchmarking purposes)*
- f. *Current population and five-year projection by age cohort*
- g. *Staffed vs. licensed beds (including beds per 1,000)*
- h. *Applicant hospital's occupancy rate*
- i. *Competitors' occupancy rates*
- j. *Outpatient volume*
- k. *Availability of emergency services*
- l. *Teaching hospital status*
- m. *Services offered by hospitals in the service area*

- n. Migration of patients out of the service area*
- o. Planned construction at other facilities in the region*
- p. Historical market share by major service category*
- q. Disproportionate Share Hospital designation*
- r. Distance to other hospitals*

In conjunction with these factors, HUD's review of market need has historically taken into consideration the following language in Section 242 (f): "The activities and functions provided for in this section shall be carried out by the agencies involved so as to encourage programs that undertake responsibility to provide comprehensive health care, including outpatient and preventive care, as well as hospitalization, to a defined population, and, in the case of public hospitals, to encourage programs that are undertaken to provide essential health care services to all residents of a community regardless of ability to pay."

The proper place for the applicant to establish that the proposed project meets the "need" requirement is the Study of Market Need and Financial Feasibility. The Study of Market Need and Financial Feasibility shall include a section establishing that the hospital is needed based on the elements listed above. This section shall include a summary paragraph that draws together the analysis of the need for the hospital (or project in limited circumstances) based upon the relevant elements listed above. The opinion letter by the accountant addresses the reasonableness management's assertion that the hospital is a "needed hospital."

REQUIREMENT FOR OPINION BY ACCOUNTANT

"As stated above, the study of market need and financial feasibility must be prepared in accordance with AICPA guidelines. The certified public accountant's opinion letter that accompanies the study must include a statement addressing market need as well as a statement addressing the ability of the hospital to service the mortgage."

POTENTIAL SITUATIONS THAT MAY REQUIRE A MODIFICATION OF THE STANDARD OPINION IN THIS POLICY

- Critical Access Hospitals (CAH) are recognized as meeting the need criteria for Section 242 except in limited circumstances. In many cases CAH hospitals are not required to submit an exam level Study of Market Need and Financial Feasibility. Instead they submit a compilation as outlined in the CAH guidelines. If a CAH hospital designation is made based on the determination of the Governor of the State rather than meeting the general distance criteria, HUD may request that a full Study of Market Need and Financial Feasibility be done by the hospital. If HUD requests that the hospital submit an exam level study of Market Need and Financial Feasibility then the report formats and guidelines that are in this policy apply to that report.

- Applications for mortgage insurance under Section 241 are for hospitals that are already in the HUD portfolio. HUD has already determined that the hospital meets the requirement for need. In most cases, it will not be necessary to again establish that the hospital is needed as that determination has already been made. It is therefore anticipated that hospitals requesting insurance for a loan increase under Section 241 may, at the sole discretion of HUD, submit a Study of Financial Feasibility instead of a Study of Market Need and Financial Feasibility. However, if the proposed project includes an expansion of beds or the addition of a new service line, HUD may request an exam level Study of Market Need and Financial Feasibility. If such a study is requested, the guidelines in this policy will apply with the modification that the report should refer to the need for the proposed expansion of beds or proposed service line instead of for the need for the hospital
- In certain situations, a hospital is not required to submit an exam level report. The hospital may qualify to submit a report that is self-prepared or a compilation with special procedures. In such cases the CPA is not required to address the issue of need in their report. However, the Study of Market Need and Financial Feasibility must substantiate the need for the hospital in accordance with the listed criteria.

FORM OF OPINION

The AICPA guidelines provide sufficient flexibility to include a statement regarding need in the expanded form of the standard opinion letter (paragraph 17.27 of Guide for Prospective Financial Information; April 1999). However, paragraphs 17.23-24 of the AICPA guidelines also provide for issuing a separate report “on certain nonaccounting information or other information...”

HUD has therefore determined that the statement addressing market need from the CPA may be presented as a part of the standard opinion letter or as a separate letter. HUD prefers the statement to be included as a part of the standard opinion letter.

[PREFERRED STYLE]

PROPOSED WORDING TO BE USED IN AN EXAMINATION OF PROSPECTIVE FINANCIAL STATEMENTS REPORT TO COMPORT WITH MORTGAGEE LETTER 04-08:

To be included in section "e" of example report paragraph 17.27 of AICPA "Guide for Prospective Financial Information":

*Our procedures included analysis of -
“Current and future market need as required by HUD Mortgagee Letter 04-08”*

The accountant may (at the accountant's option) include a separate paragraph on need in accordance with paragraph 17.17 *Emphasis of a matter* of the AICPA "Guide for Prospective Financial Information."

To be included in section "k" of example report paragraph 17.27 of AICPA "Guide for Prospective Financial Information"):

Our conclusions are presented below:

"In our opinion, the underlying assumptions provide a reasonable basis for management's forecast including management's assertion that the hospital is needed. However, there will...."

[OPTIONAL STYLE 2]

PROPOSED WORDING TO BE USED IN A SEPARATE LETTER TO ACCOMPANY EXAMINATION OF PROSPECTIVE FINANCIAL STATEMENTS REPORT TO COMPILE WITH MORTGAGEE LETTER 04-08:

*Board of Directors
Community Hospital
Middletown, USA*

We have prepared a financial feasibility study of Community Hospital plan to The study was undertaken to evaluate the ability of the Hospital to meet its operating expenses, working capital needs, and other financial requirements, including the debt service requirements associated with the proposed \$xxx,xxx,xxx mortgage obligation, at an assumed annual borrowing rate of 5.25%, including mortgage insurance premium of 0.5% during the period of January 1, 20XX through December 31, 20YY. We issued our report, including our conclusion, on September 1, 20XX.

This letter is a supplement to our report dated September 1, 20XX addressing the U.S. Department of Housing and Urban Development's requirement as published in the Mortgagee Letter 04-08 dated February 23, 2004 that "the certified public accountant's letter that accompanies the study must include a statement addressing market need...."

[Optional paragraph to emphasize some of the key elements that demonstrate that the hospital is needed as outlined in the study].

Accordingly, in our opinion the underlying assumptions of the aforementioned financial feasibility study provide a reasonable basis for management's financial forecast, including the assumption that the Hospital could achieve occupancy rates during the year of the forecast and for management's assertion that the hospital is needed. The financial forecast is based on the achievement of management's assumption on demand and utilization.

This letter is intended solely for the information and use of the Board, Management and the U.S. Department of Housing and Urban Development and should be read in conjunction with the financial feasibility study dated September 1, 20XX.

[OPTIONAL STYLE 3]

PROPOSED WORDING FOR INDEPENDENT ACCOUNTANT'S REPORT - where letter is attached to a separate report addressing need in accordance with HUD requirements. If using this format, the accountant must provide a crosswalk between the Report on Need and the project description, market area, demographic and related sections of the Financial Forecast and shall highlight any differences between the two reports:

We have examined management's assertion, as attached, that Community Hospital (the "Hospital") meets market need in accordance with section 242 of the National Housing Act, as amended, by PL108-91 and as addressed in the U.S. Department of Housing and Urban Development ("HUD") Mortgagee Letter 04-08 (the "Mortgagee Letter"). Hospital management is responsible for the assertion. Our responsibility is to express an opinion on the assertion based on our examination. Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence supporting management's assertion and performing such other procedures as we considered necessary in the circumstances. A portion of the procedures were performed during the examination of the financial forecast of YYY dated XXX. We believe that our examination provides a reasonable basis for our opinion.

The criteria used to examine, evaluate and present the subject matter of management's assertion were derived from the Mortgagee Letter and included the following.

- a. Service area definition*
- b. Existing or proposed hospital*
- c. Designation as sole community provider, critical access hospital, or rural referral center*
- d. Community-wide use rates (discharges and days/1000)*
- e. State-wide use rates (for benchmarking purposes)*
- f. Current population and five-year projection by age cohort*
- g. Staffed vs. licensed beds (including beds per 1,000)*
- h. Applicant hospital's occupancy rate*
- i. Competitors' occupancy rates*
- j. Outpatient volume*
- k. Availability of emergency services*
- l. Teaching hospital status*
- m. Services offered by hospitals in the service area*
- n. Migration of patients out of the service area*
- o. Planned construction at other facilities in the region*
- p. Historical market share by major service category*
- q. Disproportionate Share Hospital designation*
- r. Distance to other hospitals*

In our opinion, Community Hospital management's assertion referred to above is fairly stated, in all material respects, based solely on the Mortgagee Letter criteria.

This report is intended solely for the information and use of management of Community Hospital and the U.S. Department of Housing and Urban Development and is not intended to be and should not be used by anyone other than these specified parties.

Signature